DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER 05-0011P
TAX ADMINISTRATION (USE TAX)—NEGLIGENCE PENALTIES FOR THE REPORTING PERIODS COVERING CALENDAR YEARS 2000-01 AND JANUARY 1—NOVEMBER 30, 2002

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ISSUES

I. Tax Administration—Negligence Penalties—Audit Deficiencies—Good Payment History

Tax Administration—Negligence Penalties—Audit Deficiencies—Lack of Proof of Neglect

Authority: IC §§ 6-8.1-5-1(b) and -10-2.1 (2004); 45 IAC §§ 15-5-3(b)(8) and -11-2 (2004)

II. Tax Administration—Negligence Penalties—Audit Deficiencies—Lack of Proof of Intent to Defraud

Authority: IC §§ 6-8-1-24, -8.1-5-1(b), -8.1-10-2.1 and -8.1-10-4 (2004); *State Bd. of Tax Comm'rs v. New Castle Lodge # 147, L.O.O.M.*, 765 N.E.2d 1257, 1264 (Ind. 2002); *Hoogenboom-Nofziger v. State Bd. of Tax Comm'rs*, 715 N.E.2d 1018, 1024 and 1024-25 (Ind. Tax Ct. 1999); 45 IAC §§ 15-3-2(e), -5-3(b)(8) -11-2 -11-4 and (2004)

The taxpayer protests the Audit Division's proposed assessment of negligence penalties.

STATEMENT OF FACTS

The Department's Audit Division conducted a field audit of the taxpayer for the tax type and reporting periods set out in the heading of this Letter of Findings. As a result of the audit, the taxpayer incurred tax deficiencies. The Audit Division proposed assessing, and the taxpayer has protested only proposed assessment of, negligence penalties. The Department will provide additional information as needed.

I. Tax Administration—Negligence Penalties—Audit Deficiencies—Good Payment History

Tax Administration—Negligence Penalties—Audit Deficiencies—Lack of Proof of Neglect

DISCUSSION

A. TAXPAYER'S ARGUMENT

The taxpayer submits that one reason the Department should waive the negligence penalties is that it has consistently remitted tax due and that the audit did not disclose any evidence of neglect.

B. ANALYSIS

IC § 6-8.1-10-2.1 (2004) is the statute that authorizes the Department to impose a penalty for any negligence of a taxpayer in failing to comply with the tax laws that the Department administers. These taxes are listed in IC § 6-8.1-1-1 and include the gross retail and use tax. IC § 6-8.1-10-2.1(a)(3) states that "(a) [i]f a person: … (3) [i]ncurs, upon examination by the department, a deficiency that is due to *negligence*; … the person is subject to a penalty." *Id.* (Emphasis and alterations added). The amount is set by IC § 6-8.1-10-2.1(b)(4), which states that "(b) [e]xcept as provided in subsection (g) [,] [not in issue here], the penalty described in subsection (a) is ten percent … of:… (4) the amount of deficiency as finally determined by the department[.]" *Id.* (Alterations added.) However, IC § 6-8.1-10-2.1(d) states that "[i]f a person subject to the penalty imposed under this section can show that the failure to…pay the deficiency determined by the department was due to *reasonable cause* and not due to willful neglect, the department shall waive the penalty." *Id.* (Emphasis and alteration added).

Title 45 IAC § 15-11-2(b) states:

> (b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's *carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence.* Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Id. (Emphasis added.) The next subsection of the regulation sets out the standard of care a taxpayer must prove pursuant to IC § 6-8.1-10-2.1(e) to establish reasonable cause for failing to

meet its tax compliance duties to the Department. Subsection (c) of 45 IAC § 15-11-2 reads in relevant part as follows:

> (c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 [sic][should read IC 6-8.1-10-2, repealed and re-enacted in 1991 as IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to…pay a deficiency was due to reasonable cause and not due to negligence. *In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.*…
>
> …
>
> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Id. (Emphasis and alterations added.)

Under IC § 6-8.1-5-1(b) (2004) and 45 IAC § 15-5-3(b)(8) (2004), the person against whom a proposed assessment is made has the burden of proving that it is wrong. That burden applies to abatement of penalty assessments, as well as substantive tax assessments. *"A person who wishes to avoid the penalty imposed under [IC § 6-8.1-10-2.1(a) and (b)] must make an affirmative showing of all facts alleged as a reasonable cause* for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust[.]" IC § 6-8.1-10-2.1(e) (emphasis and alterations added). The burden of proof is not on the Department to show the absence of reasonable cause for the actions or inaction of a taxpayer. It follows that the Department also is not required to prove negligence, willful or otherwise, by a taxpayer, as the present taxpayer suggests. Accordingly, the Department summarily denies the taxpayer's protest to the extent it is based on this particular argument.

The taxpayer's other argument on this issue is in effect that it exercised ordinary care and prudence in remitting tax to this Department, thereby implying that it had "reasonable cause," as 45 IAC § 15-11-2(c) defines that term, for its incurring audit deficiencies. That argument does not support the taxpayer's protest because it does not address the basis on which the negligence penalties were proposed against it. The taxpayer was not penalized by the Compliance Division under IC § 6-8.1-10-2.1(a)(2) for failing to pay the full amount of tax shown on its returns. It was penalized by the Audit Division under IC § 6-8.1-10-2.1(a)(3) for "[i]ncur[ring], upon examination by the department, a deficiency that is due to negligence[.]" *Id.* (Alterations added.) The fact that the taxpayer paid all the tax it reported has no tendency to prove that the present deficiencies, resulting from its omissions of tax from its returns, were incurred for reasonable cause. The taxpayer has therefore failed to sustain its burden of proof concerning the proposal of the negligence penalties to the extent it has based its protest on this ground.

FINDING

The taxpayer's protest is denied to the extent it is based on this issue.

II. Tax Administration—Negligence Penalties—Audit Deficiencies—Lack of Proof of Intent to Defraud

A. TAXPAYER'S ARGUMENT

The taxpayer submits that the other reason the Department should waive the negligence penalties is that the taxpayer had no intent to defraud.

B. ANALYSIS

This argument, like the one regarding consistent payment of tax, does not address the reason why the Audit Division proposed the penalties, and in particular the kind of penalties, it did. The Audit Division propose those penalties under IC § 6-8.1-10-2.1 for negligence , not under IC § 6-8.1-10-4 (2004) for civil fraud. Both statutes set their respective penalties as a percentage of the tax in question. IC § 6-8.1-10-2.1(b) sets the negligence penalty at only 10 percent. In contrast, IC § 6-8.1-10-4(b) sets the civil fraud penalty at 100 percent, the maximum penalty the Department can assess. IC § 6-8.1-10-7. In addition, the civil fraud penalty "is imposed in place of and not in addition to the penalty imposed under section 2.1 of this chapter[i.e., IC § 6-8.1-10-2.1]." IC § 6-8.1-10-4(d) (alteration added).

The two penalties also differ in several other important ways, the first and most important of which for present purposes is the state of mind required to support each penalty. The statute imposing the penalty in question, a regulation implementing that statute, or both, explicitly defines the mental state required for that penalty. Comparing these definitions makes the difference between these states of mind clear. To be liable for the civil fraud penalty of IC § 6-8.1-10-4, a taxpayer must have failed to file a return, or failed to pay in full the tax reported on any filed return, "with the fraudulent intent of evading the tax[.]" *Id.*(a) (alteration added). One of the implementing regulations, 45 IAC § 15-11-4 (2004), describes "the [kind of] intent required [to constitute fraud as having] the specific purpose of evading tax believed to be owing." *Id.* (Alterations added.)

Civil tax fraud in Indiana is thus what lawyers who practice criminal law call a "specific intent" offense. *Cf.* IC § 6-8-1-24 (requiring intent to defraud the state or to evade payment of tax for certain actions described therein to be criminal tax offenses). In contrast, as previously noted, under IC § 6-8.1-10-2.1 "[n]egligence would result [merely] from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations." 45 IAC § 15-11-2(b) (alterations added). Thus, negligence requires the person penalized to have a less guilty (and more common) mental state than, and does not require proof of, intent to defraud. Conversely, fraud requires a guiltier (and hopefully rarer) state of mind than negligence does. Neither mental state is a component of the other. Each state

of mind excludes the other.

Thus, negligence does not require intent to defraud, the taxpayer's implied assertion to the contrary notwithstanding. However, absence of intent to defraud is not the same as proof that a taxpayer had reasonable cause for failing to meet its compliance responsibilities. The taxpayer has failed to submit any evidence showing, or make any argument, that it had reasonable cause for incurring the audit deficiencies. Indiana law is settled that this state's taxation hearing officers, and by extension the state-level taxing authorities of which they are agents, "do not have the duty to make a taxpayer's case." *Hoogenboom-Nofziger v. State Bd. of Tax Comm'rs*, 715 N.E.2d 1018, 1024 (Ind. Tax Ct. 1999), *cited with approval in State Bd. of Tax Comm'rs v. New Castle Lodge # 147, L.O.O.M.*, 765 N.E.2d 1257, 1264 (Ind. 2002). The Tax Court stated the rationale for this rule in *Hoogenboom-Nofziger* as follows:

> [T]o allow [a taxpayer] to prevail after it made such a cursory showing at the administrative level would result in a tremendous workload increase for [the Department and] the State Board [now the Indiana Board of Tax Review], … administrative agenc[ies] that already bear[ ] … difficult burden[s] in administering this State's [listed and] property tax system[s]. If taxpayers could make a de minimis showing and then force [the Department or] the State Board to support its decisions with detailed factual findings, the [Indiana taxing authorities] would be overwhelmed with cases such as this one. This would be patently unfair to other taxpayers who do make detailed presentations to the [taxing authorities] because resolution of their appeals would necessarily be delayed.

715 N.E.2d at 1024-25 (alterations added).

FINDING

The taxpayer's protest is denied.

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